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HOUSE REPUBLICAN CONFERENCE
CHAIRMAN ADAM PUTNAM WASHINGTON D.C. 226-2302

H.R. 3648 – To amend the Internal Revenue Code of 1986 to exclude discharges of indebtedness on principal residences from gross income, and for other purposes

FLOOR SITUATION

H.R. 3648 is being considered on the floor under suspension of the rules and will require a two-thirds majority vote for passage. H.R. 3648 was introduced by Representative Charles Rangel (D-NY) on September 25, 2007, and was ordered reported, as amended, by voice vote, from the House Ways and Means Committee on September 26, 2007. The bill passed the House by a vote of 386 to 27 on October 4, 2007. The Senate passed an amended version of the bill by unanimous consent on December 14, 2007.

This legislation is expected to be considered on the floor of the House of Representatives on December 18, 2007.

SUMMARY

<ins>Cancellation of Indebtedness Income</ins>: H.R. 3648 relieves individuals who receive debt forgiveness on a mortgage from having the sum of the forgiven debt treated as taxable income, effective for debts forgiven on or after January 1, 2007 through January 1, 2010.

> **Note: The House-passed version of H.R. 3648 would have made this provision permanent. In a proposal issued by the President, a similar provision was limited to a three year, temporary suspension of this tax law. The provision is estimated to reduce revenues by $606 million over ten years.*

<ins>Treatment of Mortgage Insurance Premiums as Interest</ins>: The bill extends the tax deduction for the cost of private mortgage insurance for certain low-income individuals through the end of 2010.

> **Note: The House-passed version of H.R. 3648 would have extended the tax deduction through the end of 2014. The provision is estimated to reduce revenue by $191 million over ten years.*

<ins>Alternative Tests for Qualifying as Cooperative Housing Corporation</ins>: H.R. 3648 lowers the threshold for buildings to qualify as cooperative housing corporations, which thereby allows tenants of the corporations to receive tax deductions on their proportionate share of real estate taxes and mortgage interest paid on the property.

Note: The JCT estimates that this provision will decrease federal revenues by $22 million over the 2008-2017 period.

Students and Low Income Housing Tax Credits: H.R. 3648 allows a parent who is a full-time student to qualify for housing in a low income housing tax credit (LIHTC) unit even if the child is claimed by the other parent as a dependent. Under current law, full-time students are ineligible for LIHTC units unless they are (1) a single parent and (2) their child is not a dependent of someone else. For example, a divorced mother attending community college full-time would be disqualified if her ex-husband claims the child as a dependent on his tax return.

Note: No similar provision was included in the House-passed version of the bill. It is not estimated to have any revenue impact.

Capital Gains Exclusion for Surviving Spouse: H.R. 3648 allows a surviving spouse to use the entire $500,000 exclusion on the sale of a principal residence that he or she occupied with a deceased spouse if the sale occurs within two years of the spouse's death. Under current law, married couples are allowed to exclude up to $500,000 in gain on the sale of a primary residence; that figure drops to $250,000 for single filers.

Note: No similar provision was included in the House-passed version of the bill. The provision is expected to reduce revenues by $67 million over ten years.

Penalties on Partnerships and "S-Corporations": H.R. 3648 increases the penalty on Partnerships that fail to file tax returns from $50 for each partner for every month that the failure continues for up to five months to $85 per month for up to twelve months. The bill also creates a parallel penalty for S-Corporations that fail to file tax returns in the amount of $85 per shareholder per month that the failure continues for up to twelve months.

Note: These provisions are estimated to increase revenues by $1.276 billion over ten years. The House-passed version of H.R. 3648 used different revenue raisers. These increased penalties were passed by the House as the revenue raisers for H.R. 3997.

BACKGROUND

The number of American consumers that are defaulting on their mortgage payments has increased as average prices for homes sold in the United States have continued to decline. The majority of the loan defaults have been on "sub-prime" home loans that are designed for home buyers with damaged credit or limited credit histories. Worldwide markets have reacted with investors moving their money away from American mortgage backed securities and in August average stock prices in U.S. markets declined as investors worried of the impact of more mortgage delinquencies. Multiple U.S. mortgage lenders have filed for bankruptcy and hedge funds that invested heavily in the sub-prime mortgage market have experienced record losses.

The Federal Reserve Bank responded by cutting interest rates in early August, and again in September, stating that "Economic growth was moderate during the first half of the year, but the tightening of credit conditions has the potential to intensify the housing correction and to restrain economic growth more generally. Today's action is intended to help forestall some of the adverse effects on the broader economy that might otherwise arise from the disruptions in financial markets and to promote moderate growth over time." (Board of Governors of the Federal Reserve System Release, September 18, 2007)

On August 31, 2007, President Bush announced a plan with "…steps that the federal government can take to help homeowners in need of assistance avoid foreclosure. These steps will help homeowners having difficulty paying their mortgages and ensure that the problems now disrupting the housing industry do not happen again. The fundamentals of America's economy are strong – economic growth is healthy, wages are rising, and unemployment is low. The markets are in a period of transition as participants are re-assessing and re-pricing risk. One area that has shown particular strain is the mortgage market, particularly the subprime sector."

H.R. 3648 is similar to step two of the President's plan in which: "The President calls on Congress to change a key housing provision of the federal tax code so it does not punish families who are forced to sell their homes for less than their mortgage is worth. Current tax law counts cancelled mortgage debt on primary residences as taxable income. For example, if the value of a home declines and $20,000 of the homeowner's loan is forgiven, the tax code treats that $20,000 as taxable income. The President proposes temporary relief to ensure that cancelled mortgage debt on a primary residence is not counted as income." (Fact Sheet on the President's Mortgage Plan)

COST

Joint Committee on Tax: Estimated Revenue Effect, H.R. 3648

STAFF CONTACT

For more information or questions please contact Shea Loper at (202) 226-2302.